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December 17, 2007

## **AGENDA ITEM 4c**

### **TO: MEMBERS OF THE INVESTMENT COMMITTEE**

- I. SUBJECT:** Inflation-Linked Asset Class – Update on Implementation
- II. PROGRAM:** Total Fund
- III. RECOMMENDATION:** Information
- IV. ANALYSIS:**

### **BACKGROUND**

The purpose of this item is to provide a monthly update to the Investment Committee on the progress of the various steps required for implementation of the Inflation-Linked Asset Class (ILAC). The ILAC was approved as a pilot program in September 2007 and is now recommended to be a regular asset class as part of the Strategic Policy Allocation. With the approval of the recommended Strategic Policy Allocation (Item 4b), staff will proceed with the steps to make Inflation-Linked Assets a permanent asset class. The Committee has required that a number of steps need to be in place before proceeding with new investments in ILAC.

### **INVESTMENT POLICIES**

Policies for the ILAC and its four components (Commodities, Inflation-Linked Bonds, Infrastructure, and Forestland) were expected to be submitted to the Policy Subcommittee in December. All policies except Infrastructure were submitted to the Policy Subcommittee in December 2007. The Infrastructure policy is deferred to a future Policy Subcommittee meeting in 2008 since it is more complex and requires further development.

## ORGANIZATION

As outlined in the November 13, 2007 agenda item 4b (Attachments 1 and 2), the Inflation-Linked Asset Class (ILAC) will be managed by the Senior Investment Officer-Asset Allocation/Risk Management (SIO-AA), within the Investment Office Asset Allocation and Risk Management Unit. The ILAC group will be one of three groups within the Unit. This structure and the related staffing are reflected on the attached organization chart (Attachment 3). (The current organization chart is shown in Attachment 4).

The SIO-AA will have the responsibility for the ILAC and its four components (Commodities, Inflation-Linked Bonds, Infrastructure, and Forestland) in terms of allocations, performance and compliance with approved ILAC policy.

Commodities will report directly to the SIO-AA. Inflation-Linked Bond portfolio will be managed within Global Fixed Income (GFI) on a day-to-day basis on behalf of the ILAC in a "client-manager" relationship. ILAC is the client and GFI is the manager. The SIO-AA and SIO-GFI will agree on a process for this relationship. Infrastructure and Forestland will report directly to the SIO-AA once the positions are staffed. Until then existing investments in Infrastructure and Forestland will be managed within the Alternative Investments Management Unit and the Real Estate Unit where these investments originated. Once core staff is hired for Infrastructure and Forestland the responsibility for existing investments and new investments will transfer to the Asset Allocation Unit. This is expected to take place on or before July 1, 2008.

The specific positions being used to staff the ILAC group are as follows:

Commodities: One Portfolio Manager position. This position has been transferred from the GFI Unit. This position was established effective in July 2007 to staff the Commodities pilot program previously housed in the GFI Unit.

Infrastructure and Forestland: One Senior Portfolio Manager, one Portfolio Manager, and two Investment Officer positions. With one exception, these positions are being requested through the pending 2007-08 mid-year and the 2008-09 budget year processes. Upon approval, they will be established within the Asset Allocation Unit, and recruitment will begin immediately. One of the Investment Officer positions already exists within the Asset Allocation Unit; and has been redirected to the ILAC group. None of the positions for Infrastructure and Forestland have been redirected from other Investment Office Units.

Inflation-Linked Bonds: The positions responsible for these investments will continue to reside within the GFI Unit.

### DELEGATIONS

The Delegation Resolution for the SIO-Asset Allocation to include ILAC will be presented to the Investment Committee in February 2008.

### INCENTIVE PLAN

The performance (incentive) plans for all eligible staff involved in the management of the ILAC with appropriate changes will be presented to the Performance and Compensation Committee in February 2008. The SIO-AA will have a performance target linked to the total return of the ILAC relative to the approved benchmark. The performance plan of the Commodities Portfolio Manager will be linked to the return of the commodities total return relative to the benchmark. Staff involved in the management of the Inflation-Linked Bond (ILB) portfolio has other duties within the Global Fixed Income Unit; thus their performance plans will be amended to include the performance targets for ILB. Performance plans for Infrastructure and Forestland staff will be submitted once these positions are filled. These plans will be linked to the performance of the respective portfolios relative to those benchmarks.

### IMPLEMENTATION

Upon approval of the IL asset class target allocation and policies and meeting the pre-conditions (organization structure, staffing, incentive plan, delegations) implementation will begin as follows:

Commodities: Current portfolio will be scaled up at the earliest opportunity; the target date is March 1, 2008.

Inflation-Linked Bonds: Portfolio will begin investing at the earliest opportunity; the target date is March 1, 2008.

Infrastructure: New investments may begin as soon as pre-conditions (staffing, organization structure, delegations, investment plans) are met which is expected to be no later than July 1, 2008.

Forestland: Additional investments may begin as soon as pre-conditions (staffing, organization structure, delegations, investment plans) are met which is expected to be no later than July 1, 2008.

**V. STRATEGIC PLAN:**

This item is consistent with Strategic Plan Goal VIII, manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits, and second, to minimize and stabilize contributions. This item is also consistent with Goal IX, achieve long-term, sustainable, risk-adjusted returns.

**VI. RESULTS/COSTS:**

This item is not expected to have any material cost impact other than costs associated with managing the ILAC.

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